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United States Court of Appeals
Tenth Circuit

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PUBLISH

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

GREGORY DRONSEJKO; PEDRO GARCIA; ANTHONY MIELEC, PERLA SIERRA; CLAUDIO BORGHESAN; JERALD F. HASSLER; ANDY BEICHERT; JEFFREY BASH; TOM CHEN; CHRIS DAVIDSON; MICHAEL SPEAKMAN,

Plaintiffs - Appellants,

v.

GRANT THORNTON,

Defendant - Appellee.

Nos. 09-4222 and 10-4074

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
(D.C. No. 2:05-CV-00204-DB)

Ira M. Press (and Sarah G. Lopez of Kirby, McInerney, L.L.P.; Jonathan Gardner and Carol Villegas of Labaton, Sucharow, L.L.P., New York, New York; Jefferson W. Gross and Richard D. Burbidge of Burbidge, Mitchell & Gross, Salt Lake City, Utah, on the brief), New York, New York, for Plaintiffs - Appellants.

Gary F. Bendinger (and Christopher B. Sullivan of Howrey, L.L.P., with him on the brief), Salt Lake City, Utah, for Defendant - Appellee.

Before **TACHA**, **KELLY**, and **MURPHY**, Circuit Judges.

KELLY, Circuit Judge.

This is a securities class action pursuant to Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5, brought on behalf of class members who purchased iMergent common stock between October 15, 2002 and October 7, 2005. Aplt. App. 47, 60-63, 105-107. The basis of the claim is improper revenue recognition that materially overstated revenues and earnings and, in August 2005, led to a restatement of iMergent's financial statements for fiscal years 2002, 2003, and 2004. Aplt. App. 70, 91, 106. All claims against iMergent and its directors have settled. Aplt. App. 47. The only remaining defendant is Grant Thornton, iMergent's independent auditor which expressed unqualified or "clean" opinions on iMergent's financial statements for those fiscal years. Aplt. App. 47, 48-49.

Plaintiffs-Appellants contend that Grant Thornton's actions relating to the revenue recognition policy—particularly its expression of unqualified opinions on the financial statements—artificially inflated the market price of iMergent's stock, causing them to suffer damages when the price declined upon news of the revenue recognition problems and restatement of earnings. Aplt. App. 107; Aplt. Br. 4-5.

Two appeals have been consolidated for argument and resolution. No. 09-4222 is Plaintiffs' appeal from the district court's dismissal of the Second

Amended Consolidated Complaint for failure to properly plead scienter under the Private Securities Litigation Reform Act of 1995. Aplt. App. 501. No. 10-4074 is Plaintiffs' appeal from the district court's denial of their Rule 60(b) motion, in which Plaintiffs sought the opportunity to file a new amended complaint to incorporate newly discovered evidence. Aplt. App. 663. We have jurisdiction pursuant to 28 U.S.C. § 1291, and we affirm.

Background

For purposes of this appeal, we must take as true all factual allegations in the complaint. See Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 322 (2007). iMergent is an e-services company that, *inter alia*, sold licenses for software designed to help small businesses engage in e-commerce. Aplt. App. 47, 57. Roughly half of iMergent's revenue during the relevant period came from the sale of licenses on the basis of Extended Payment Term Arrangements ("EPTAs"). Aplt. App. 57; Aplt. Br. 9. Under EPTAs—as opposed to cash or credit card sales—customers paid the purchase price in installments over a twenty-four month period. Aplt. App. 57. iMergent recognized 100% of the revenue from EPTA sales on the date the license was delivered; however, on average iMergent collected only 53% of the total purchase price.[1] Aplt. App. 57,

[1] There is evidently a dispute as to whether EPTAs should have been treated as one source of revenue or two for purposes of revenue recognition. Aplt. Br. 9-10. iMergent divided its EPTAs into two "tiers" depending upon the

159, 468. On its 2003 and 2004 10K forms, iMergent disclosed that 47% of its EPTA sales were uncollectible and recognized bad debt expense associated with these sales, which reduced its total income. Aplt. App. 158-59, 162-53, 467-68. Further, iMergent wrote off the uncollectible EPTA accounts against an allowance for doubtful accounts, with the allowance established at the time of sale. Aplt. App. 159, 468.

Companies must adhere to generally accepted accounting principles ("GAAP") when recognizing revenue in their publicly disclosed financial statements. See Ganino v. Citizens Utils. Co., 228 F.3d 154, 159 n.4 (2d Cir. 2000) (explaining how GAAP are established); 17 C.F.R. § 210.4-01(a)(1) (incorporating GAAP into SEC disclosure requirements). Under the American Institute of Certified Public Accountants ("AICPA") Statement of Position 97-2 ("SOP 97-2")—the relevant GAAP for our purposes—companies may immediately recognize revenue from software licenses sold on the basis of extended-term contracts so long as: (1) persuasive evidence of an arrangement exists; (2) delivery of the product has occurred; (3) the fee is fixed and determinable; and (4) collectibility is probable. Aplt. App. 49, 57; Barrie v.

credit rating of the purchaser. Aplt. App. 49. So-called "A-tier" EPTAs had a collection rate of greater than 50% (neither party provides the exact percentage), and "B-tier" EPTAs had a collection rate of less than 50%. Aplt. App. 49. iMergent combined these two tiers for purposes of recognizing revenue, whereas Plaintiffs imply that they should have been treated separately. Id.; Aplt. Br. 9-10. This dispute has no effect on the outcome of this case.

Intervoice-Brite, Inc., 397 F.3d 249, 256 (5th Cir. 2005) (applying SOP 97-2 as the relevant AICPA and GAAP standard). "Probable" has the same definition as used in FASB Statement No. 5, Accounting for Contingencies. Aplt. App. 71. That statement defines probable as: "The future event or events are likely to occur." Aplt. App. 71. No GAAP pronouncement establishes a percentage for "probable collectibility" under SOP 97-2.

In 2002, the SEC sent a letter inquiring about iMergent's revenue-recognition practices. Aplt. App. 85. iMergent, after consulting with Grant Thornton, responded that its collection rate for EPTAs was around 70%. Aplt. App. 86. The SEC was satisfied with iMergent's response and took no further action. Aplt. App. 87. The 70% figure, however, reflected the collection rate for executory EPTAs—the collection rate for EPTAs upon completion of the entire two-year term was projected to be 53%. Aplt. App. 86.

In 2005, the SEC again inquired into iMergent's revenue-recognition policy. Aplt. App. 87. In its response, iMergent indicated that collection rates for EPTAs "exceed[ed] 50%" and were therefore "probably collectible" under SOP 97-2. Aplt. App. 89. The SEC responded that in order to qualify as "probable" under SOP 97-2, the collection rate must be "substantially higher than 50%." Aplt. App. 89-90. Shortly thereafter Grant Thornton withdrew its audit opinions on iMergent's financial statements, Aplt. App. 90-91, and iMergent was forced to alter its method of recognizing revenue and restate its financial

statements for fiscal years 2002, 2003, and 2004. Aplt. App. 67-68, 91-92. The restatements drastically lowered revenues—revenues had been overstated by 372%, 279%, and 301% respectively—and earnings became losses for each of the three years. Aplt. App. 68; Aplt. Br. 18. Not surprisingly, the stock price declined. Aplt. App. 93.

A company's management—not the auditor—is responsible for the information contained in its financial statements and the propriety of its underlying accounting policies, including compliance with GAAP. See Deephaven Private Placement Trading, Ltd. v. Grant Thornton & Co., 454 F.3d 1168, 1174-75 (10th Cir. 2006). However, Grant Thornton is responsible for its audit reports, which contained its unqualified opinions on iMergent's financial statements for fiscal years 2002, 2003, and 2004. Aplt. App. 48-49. According to the complaint, Grant Thornton falsely represented that its audits had been conducted in accordance with generally accepted auditing standards ("GAAS") and wrongfully issued opinions that the financial statements fairly presented iMergent's financial condition and results of operations in conformity with GAAP. Aplt. App. 50, 62, 64, 66-67; Aplt. Br. 3-4. Plaintiffs contend that, contrary to its unqualified opinions, Grant Thornton knew or was reckless in not knowing that iMergent's revenue recognition policy violated GAAP. More specifically, Plaintiffs allege that Grant Thornton knew or was reckless in not knowing that the 53% collection rate on EPTAs did not meet the "probable

collectibility" standard under SOP 97-2.[2] Aplt. App. 67; Aplt. Br. 4.

A. The Second Amended Complaint

In March 2005, Plaintiffs brought suit against Grant Thornton and iMergent. Aplt. App. 26. iMergent promptly settled, and in January 2009 Plaintiffs filed a Second Amended Consolidated Complaint ("SAC" or "complaint") with Grant Thornton as the lone defendant. Aplt. App. 46. The complaint alleged that Grant Thornton violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 by recklessly certifying that iMergent's financial statements complied with GAAP and that Grant Thornton's audits complied with Generally Accepted Auditing Standards ("GAAS"). Aplt. App. 47. More particularly, Plaintiffs alleged that Grant Thornton recklessly concluded that iMergent's 53% collection rate on EPTAs satisfied SOP 97-2's "probable collectibility" standard. Aplt. App. 73. Defendants moved to dismiss the complaint with prejudice.

The district court granted Defendant's motion to dismiss, holding that the complaint failed to raise a "strong inference" that Grant Thornton acted with scienter, as is required by the Private Securities Litigation Reform Act of 1995 ("PSLRA"). See In re iMergent Sec. Litig., No. 05-cv-204, 2009 WL 3731965,

[2] Grant Thornton argues that it applied SOP 97-2's requirement of "probable collectibility" on the basis of all sales including cash, credit card, and EPTA's, and that this practice complied with GAAP. Aplee. Br. at 12, 14; but see Aplt. App. at 444 (asserting that a collection history of greater than 50% supports management's assertion of collectibility).

*7 (D. Utah Nov. 2, 2009). Specifically, the court held that Plaintiffs' "allegations fail to raise an inference of fraudulent intent that is cogent and as compelling as the competing non-culpable inference that Grant Thornton was merely negligent." Id. at *11.

Plaintiffs timely appealed. Aplt. App. 501. They argue that the complaint properly alleged Grant Thornton's reckless conduct, and that the district court erroneously held them to an intentional fraud standard. Aplt. Br. 28, 32. We review this issue *de novo*. Alvarado v. KOB-TV, LLC, 493 F.3d 1210, 1215 (10th Cir. 2007).

B. The Rule 60(b) Motion

After the district court dismissed the complaint, the Public Company Accounting Oversight Board ("PCAOB")—a private, nonprofit corporation created by the Sarbanes Oxley Act to regulate auditors of publicly traded companies—imposed sanctions on two representatives of Grant Thornton for their role in the iMergent audits. Aplt. App. 510, 525. Plaintiffs contend that the PCAOB orders and documents referenced therein constitute evidence of Grant Thornton's knowing or intentional misconduct. Aplt. Br. 19. In light of this newly discovered evidence, Plaintiffs moved under Rule 60(b)(2) for relief from the district court's dismissal with prejudice, seeking leave to amend the SAC to incorporate the new evidence. Aplt. App. 660.

The district court denied Plaintiffs' 60(b) motion on two grounds: (1) the

orders were merely summaries of the PCAOB's allegations to which the Grant Thornton representatives had stipulated, not actual findings of fact; and (2) the documents referenced by the PCAOB orders were not sufficiently important to change the outcome of court's prior decision. See In re iMergent Sec. Litig., No. 05-cv-204, 2010 WL 1331651, at *1 (D. Utah April 5, 2010). Plaintiffs timely appealed.

We review for abuse of discretion a district court's denial of a Rule 60(b) motion, keeping in mind that "Rule 60(b) relief is extraordinary and may only be granted in exceptional circumstances." See Zurich N. Am. v. Matrix Serv., Inc., 426 F.3d 1281, 1289 (10th Cir. 2005) (internal quotation marks and citation omitted). A district court abuses its discretion when it commits legal error. Lyons v. Jefferson Bank & Trust, 994 F.2d 716, 727 (10th Cir. 1993).

Discussion

A. Dismissal of the Second Amended Complaint.

Under the PSLRA, to bring a claim for violation of a securities law under which plaintiffs "may recover money damages only on proof that the defendant acted with a particular state of mind," the complaint must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added).

In Tellabs, the Supreme Court explained the PSLRA's "strong inference"

requirement. 551 U.S. at 314. The Court held that in order to give rise to a strong inference of scienter,

> [i]t does not suffice that a reasonable factfinder plausibly could infer from the complaint's allegations the requisite state of mind. Rather, . . . a court governed by [the PSLRA] must engage in a comparative evaluation; it must consider, not only the inferences urged by the plaintiff, . . . but also competing inferences rationally drawn from the facts alleged.

Id. Thus, "[t]o qualify as 'strong' within the intendment of [the PSLRA], . . . an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent." Id.

The PSLRA's heightened pleading standard applies to claims brought under the Exchange Act of 1934 and Rule 10b-5. See id. at 319. In the Tenth Circuit, "to state a claim under Section 10(b) of the [Exchange] Act and Rule 10b-5 a plaintiff must allege: (1) a misleading statement or omission of a material fact; (2) made in connection with the purchase or sale of securities; (3) with intent to defraud or recklessness; (4) reliance; and (5) damages." City of Philadelphia v. Fleming Cos., 264 F.3d 1245, 1257-58 (10th Cir. 2001) (emphasis added) (citation omitted); see also In re Williams Sec. Litig.-WCG Subclass, 558 F.3d 1130, 1136 (10th Cir. 2009) (listing substantially the same factors (citing Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, 128 S. Ct. 761, 768 (2008)). Recklessness is defined as "conduct that is an extreme departure from the

standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." Fleming, 264 F.3d at 1258 (internal quotation marks and citations omitted).

Our sister-circuits have developed a recklessness standard specifically for Section 10(b) claims against outside auditors. See Pub. Employees' Ret. Ass'n of Colo. v. Deloitte & Touche LLP, 551 F.3d 305, 315 (4th Cir. 2009); In re Suprema Specialties, Inc. Sec. Litig., 438 F.3d 256, 279 (3d Cir. 2006); PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 693-94 (6th Cir. 2004); DSAM Global Value Fund v. Altriss Software, Inc., 288 F.3d 385, 390 (9th Cir. 2002). This standard is "especially stringent," requiring "a mental state so culpable that it approximates an actual intent to aid in the fraud being perpetrated by the audited company." PR Diamonds, 364 F.3d at 693 (internal quotation marks and citation omitted). Under this standard, outside auditors act recklessly only when

> the accounting practices were so deficient that the audit amounted to no audit at all, or an egregious refusal to see the obvious, or to investigate the doubtful, or that the accounting judgments which were made were such that no reasonable accountant would have made the same decisions if confronted with the same facts.

Id., 364 F.3d at 693-94 (internal quotation marks omitted) (citing In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1426 (9th Cir. 1994) (quoting SEC v. Price Waterhouse, 797 F. Supp. 1217, 1240 (S.D.N.Y. 1992)).

Combining the PSLRA's pleading standard with the Exchange Act's

scienter requirement, the Sixth Circuit has held that to properly allege a Section 10(b) violation against an auditor or accountant, "the complaint must identify specific, highly suspicious facts and circumstances available to the auditor at the time of the audit and allege that these facts were ignored, either deliberately or recklessly." Id. at 694 (internal quotation marks and citation omitted).

In this case, we need not decide whether to adopt an auditor-specific standard for recklessness under the Exchange Act. Under either standard, the complaint fails to meet the PSLRA's heightened pleading requirement.

In examining the complaint, we must take the factual allegations as true. See Tellabs, 551 U.S. at 322. However, we need not take as true the complaint's legal conclusions—most relevant here, Plaintiffs' repeated assertions that Grant Thornton acted recklessly. Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949-50 (2009) (citing Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)). This is particularly true in this context because the PSLRA's heightened pleading standard requires the complaint to allege, with particularity, "facts giving rise to a strong inference" of scienter. 15 U.S.C. § 78u-4(b)(2) (emphasis added). We must also view the entire complaint, and not just individual allegations in isolation. Tellabs, 551 U.S. at 322.

We have considered the complaint in its entirety. However, for purposes of our analysis it is helpful to identify those factual allegations most relevant to Grant Thornton's scienter. These allegations are:

- "Grant Thornton knew the respective collection rates for . . . all EPTA contracts at all relevant times" and "had continual access to and knowledge of iMergent's confidential . . . business information," Aplt. App. 50;

- At all relevant times, the "aggregate collection rate [for EPTAs] was just above 50%," Aplt. App. 50;

- SOP 97-2 defines "probable" with reference to FASB statement No. 5, which defines "probable" as "the future event or events are likely to occur," Aplt. App. 71;

- the FASB Staff Implementation Guide states that "probable is a higher level of likelihood than 'more likely than not,'"Aplt. App. 72;

- an accounting textbook suggests practitioners interpret "probable" "to be in the 78% range," Aplt. App. 72;

- "Grant Thornton had a lucrative relationship with iMergent which generated huge fees" and thus was "particularly motivated to appease the client because their remuneration was directly tied to the fees generated from iMergent," Aplt. App. 78;

- Grant Thornton knew of the 2002 SEC inquiry into iMergent's revenue-recognition practices, but did not reveal that the collection rate was only 53% or suggest revising the revenue recognition practices, but rather asserted to the SEC that the collection rate was 70%, Aplt. App. 87; and

- after the 2005 SEC letter informing iMergent that revenue collection had to be substantially higher than 50% in order to recognize the revenue up front, Grant Thornton withdrew its support for iMergent's revenue recognition practices instead of providing support for its prior position, Aplt. App. 89-90.

Even with these factual allegations, the complaint fails to give rise to a cogent and compelling inference that Grant Thornton's actions constituted "an extreme departure from the standards of ordinary care," Fleming, 264 F.3d at

1258 (internal quotation marks and citation omitted), or that "no reasonable accountant would have made the same decisions if confronted with the same facts." PR Diamonds, 364 F.3d at 694 (internal quotation marks and citation omitted).

As alleged in the complaint, Grant Thornton was fully aware of the facts surrounding iMergent's revenue-recognition policy. Aplt. App. 50. Indeed, in its public filings, iMergent explained that "approximately 47% of the gross amount of all EPTA's that we enter into . . . will ultimately be determined to be uncollectible." Aplt. App. 159. Grant Thornton correctly identified the appropriate GAAP standard—SOP 97-2. Aplt. App. 70-71. The problem, as alleged by the Plaintiffs, came not in conducting the audit itself, but rather in applying the facts to the relevant GAAP—allegedly without any support. In other words, Plaintiffs allege that Grant Thornton was reckless in concluding that a 53% collection rate for EPTAs constituted "probable collectibility" under SOP 97-2 without obtaining any secondary sources to support their interpretation. Aplt. Br. 28.

Plaintiffs identify two sources that indicate that the threshold for "probable" under SOP 97-2 may be greater than 53%: a FASB Staff Implementation Guide, and an auditing textbook. Aplt. App. 72.

The FASB Staff Implementation Guide indicates that application of the "probable" standard in the context of loan impairment requires judgment; it does

not mean virtually certain, but is a higher level of likelihood than "more likely than not." Aplt. App. 72 (citing FASB Staff Implementation Guide, Q&A 114–Application of FASB Statements 5 and 114 to a Loan Portfolio). However, as the district court correctly noted, the FASB Implementation Guide is low on the hierarchy of sources used to interpret GAAP. See In re iMergent Secs. Litig., 2009 WL 3731965 at *9 (citing The Meaning of Present Fairly in Conformity with GAAP, AU § 411.18 (Am. Inst. of Certified Pub. Accountants 2008)).

The auditing textbook discusses the meaning of "probable" in the context of disclosing material loss contingencies. See Wanda A. Wallace, Auditing 955-56 (3d ed. 1995). It states, without citation, that "research suggests that a 78 percent range is encompassed in practice." Id. However, the textbook does not establish or even suggest that the 78% rate is the correct interpretation; to the contrary, it notes the controversy surrounding the definition of "probable" and offers no definitive conclusion. Id. ("Despite debates that 'probable' should be redefined as 'more likely than not,' or 50/50, the FASB has retained the Exhibit 16-2 terminology and research suggests that a 78 percent range is encompassed in practice. The General Accounting Office, a proponent of change, alleges that the language permits restrictive interpretations in the 95 percent range. The controversy is likely to continue.").

Given the ambiguity and generality of these sources, we do not think that failure to incorporate them in the revenue-recognition context is evidence of

recklessness. Moreover, both sources allude to the controversy over the meaning of probable, and neither establishes that 78% is the correct threshold for "probable collectibility" under SOP 97-2. Finally, as the district court also noted, the complaint does not allege that Grant Thornton knew about the relevant authorities yet ignored them. In re iMergent Sec. Litig., 2009 WL 3731965 at *9.

Plaintiffs plead no other facts establishing that Grant Thornton's conduct was an extreme departure from ordinary care. Instead, it appears that Plaintiffs would have us conclude that failure to consult these two less-than-specific sources constitutes recklessness sufficient to incur liability for fraud under the Exchange Act—a conclusion that, without more, we are unwilling to make.

On appeal, Plaintiffs make two main arguments: that the complaint alleges that Grant Thornton approved iMergent's practices "without finding *any* support," which constitutes "textbook recklessness," Aplt. Br. 28, 29; and that the district court erroneously held them to an "intentional" scienter standard, instead of the appropriate "recklessness" standard. Aplt. Br. 32. They also argue that the magnitude of the restatement supports an inference of scienter, and that Grant Thornton had a motive to engage in fraud, namely the desire to please iMergent and continue to receive large audit fees. Aplt. Br. 34; 37. These arguments are unavailing.

First, it is simply inaccurate to state that Grant Thornton did not have any support for its approval of the practices. SOP 97-2 itself does not define the

phrase "probable collectibility." Aplt. App. 49, 57. Instead, it references FASB Statement 5, which defines "probable" as "likely to occur"—a definition that does not, on its face, rule out a "more likely than not" standard. Aplt. App. 71.

Thus, while it is true that, according to the complaint, Grant Thornton did not produce any secondary sources to support its interpretation, SOP 97-2 itself and FASB Statement 5 provide some support. Although Grant Thornton's interpretation of the rule may have been incorrect or even negligent, the complaint does not establish that Grant Thornton's conduct was an "extreme departure from the standards of ordinary care," Fleming, 264 F.3d at 1258, or that "no reasonable accountant would have made the same decision[] if confronted with the same facts." PR Diamonds, 364 F.3d at 694-95.

Second, the district court did not improperly hold Plaintiffs to an intentional standard. To the contrary, the district court devoted several pages of its opinion to developing the proper recklessness standard. See In re iMergent Sec. Litig., 2009 WL 3731965 at *6-*7. Plaintiffs identify several statements that, they claim, are predicated on application of an intentional fraud standard. Aplt. Br. 33-37. That is not the case. The district court's conclusions merely recognize—correctly—that recklessness under section 10(b) is a particularly high standard. See In re iMergent Sec. Litig., 2009 WL 3731965 at *6-*7. Indeed, it is the Plaintiffs who are in error, as they appear to predicate their arguments on a standard akin to negligence or gross negligence—which is below the high

threshold for liability under Section 10(b) of the Exchange Act. See Fleming, 264 F.3d at 1258 ("Simple negligence . . . does not satisfy the scienter requirement." (citations omitted)); accord South Cherry St., LLC v. Hennessee Grp. LLC, 573 F.3d 98, 109 (2d Cir. 2009) (defining recklessness under the Exchange Act as "a state of mind approximating actual intent, and not merely a heightened form of negligence" (internal quotation marks and citation omitted)); PR Diamonds, 364 F.3d at 681-82 ("Recklessness is a mental state apart from negligence and akin to conscious disregard." (internal quotation marks and citations omitted)); In re Comshare Inc. Sec. Litig, 183 F.3d 542, 550 n.7 (6th Cir. 1999) ("[F]ederal appellate courts have long held the view that, for the purpose of securities fraud, recklessness that is far from negligence and closer to a lesser form of intent constitutes scienter." (internal quotation marks and citation omitted)).

Plaintiffs argue that the magnitude of the restatement supports an inference of scienter. Aplt. Br. 34. However, we agree with the district court that Plaintiffs failed to adequately explain the connection between the restatement and scienter. See In re iMergent Sec. Litig., 2009 WL 3731965 at *10. In this case, the allegedly reckless action is Grant Thornton's failure to provide support for its approval of iMergent's revenue-recognition policy. The magnitude of the restatement has nothing to do with Grant Thornton's scienter in applying SOP 97-2—presumably, the restatement would have been equally large had Grant Thornton acted in good faith, negligently, recklessly, or, for that matter,

intentionally. Further, even if the magnitude of the restatement is one factor supporting a finding of scienter—as Plaintiffs argue, see Aplt. Br. 34—the complaint as a whole still fails to raise a cogent and compelling inference that Grant Thornton acted with scienter.

Plaintiffs also argue that Grant Thornton had a motive to engage in fraudulent or reckless conduct: to please the client and continue to receive auditing fees. Aplt. Br. 37. While this may be true, that motive is present in every relationship between an independent auditor and a company. Plaintiffs do not allege facts tending to show that Grant Thornton's motive in this case was atypical or linked to the revenue recognition policy. Thus, Grant Thornton's motive in this case does not support an inference of scienter. Accord La. Sch. Employees' Ret. Sys. v. Ernst & Young, LLP, 622 F.3d 471, 484 (6th Cir. 2010) ("Allegations that the auditor earned and wished to continue earning fees from a client do not raise an inference that the auditor acted with the requisite scienter." (internal quotation marks and citation omitted)); In re Stone & Webster, Inc., Sec. Litig., 414 F.3d 187, 215 (1st Cir. 2005) ("[A]bsent truly extraordinary circumstances, an auditor's motivation to continue a profitable business relationship is not sufficient by itself to support a strong inference of scienter.").

Finally, the fact that iMergent publically disclosed its expected collection rate on EPTAs seriously undercuts any inference that Grant Thornton acted with the requisite scienter. The 10Ks from 2003 and 2004 clearly indicate iMergent's

revenue-recognition policy. See Aplt. 158-59, 468-69. These disclosures are more consistent with the inference that Grant Thornton made an erroneous and perhaps negligent interpretation of an ambiguous GAAP than with the inference that Grant Thornton's conduct was "an extreme departure from the standards of ordinary care" that "present[ed] a danger of misleading buyers or sellers." Fleming, 264 F.3d at 1258 (internal quotation marks and citation omitted).

It is true that the SAC may adequately plead a GAAP violation. However, it is well-established that "[c]laims of accounting irregularities or violations of [GAAP] support a claim of scienter only when coupled with evidence that the violations or irregularities are the result of the defendant's fraudulent intent to mislead investors." Pirraglia v. Novell, Inc., 339 F.3d 1182, 1191 (10th Cir. 2003) (internal quotation marks and citations omitted); see also Thompson v. RelationServe Media, Inc., 610 F.3d 628, 688 (11th Cir. 2010) (Tjoflat, J., concurring in part and dissenting in part) ("Accounting irregularities, even violations of GAAP in Sarbanes-Oxley certified accounting statements, cannot support an inference of scienter unless the officer certifying the statement was severely reckless." (internal quotation marks and citations omitted)); ECA Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co., 553 F.3d 187, 200 (2d Cir. 2009) ("Allegations of GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claims. Only where such allegations are coupled with evidence of corresponding fraudulent intent

might they be sufficient." (internal quotation marks and citation omitted)). Plaintiffs' failure to adequately allege scienter, then, is fatal to their claim notwithstanding the alleged GAAP violation.

In sum, the complaint fails to raise a strong inference that Grant Thornton acted with scienter in expressing an unqualified opinion on iMergent's financial statements. Specifically, the "plausible nonculpable" inference that Grant Thornton acted negligently is far more "cogent and compelling" than the inference that it acted sufficiently reckless to incur liability under Section 10(b) of the Exchange Act. See Tellabs, 551 U.S. at 324. Therefore, the district court correctly dismissed the complaint under the PSLRA.

B. Denial of the Rule 60(b) Motion.

Rule 60(b)(2) permits courts to grant relief from a prior judgment if the moving party presents "newly discovered evidence that, with reasonable diligence, could not have been discovered in time to move for a new trial under Rule 59(b)." Fed. R. Civ. P. 60(b)(2). Relief under Rule 60(b) is warranted only in "exceptional circumstances," and "[a] plaintiff must overcome a higher hurdle to obtain relief from a post-judgment motion than on direct appeal from a judgment." LaFleur v. Teen Help, 342 F.3d 1145, 1153 (10th Cir. 2003) (internal quotation marks and citations omitted).

To be eligible for relief under Rule 60(b)(2), the moving party must show: "(1) the evidence was newly discovered since the trial; (2) the moving party was

diligent in discovering the new evidence; (3) the newly discovered evidence [was] not merely cumulative or impeaching; (4) the newly discovered evidence is material; and (5) that a new trial with the newly discovered evidence would probably produce a different result." Zurich N. Am. v. Matrix Serv., Inc., 426 F.3d 1281, 1290 (10th Cir. 2005) (internal quotation marks and citation omitted). Of course, in this case the Plaintiffs sought relief from an order dismissing the case, not from the result of a trial—but the required showing under Rule 60(b)(2) remains the same. See Goldstein v. MCI Worldcom, 340 F.3d 238, 257-58 (5th Cir. 2003) (applying Rule 60(b)(2)'s newly discovered evidence standard to a motion for relief from the district court's dismissal of the suit).

In this case, the newly discovered evidence consists of two orders released by the PCAOB. Aplt. App. 505. Those orders contain allegations made by the PCAOB relating to Grant Thornton's audit of iMergent's 2004 financial statements. Aplt. App. 510; 525. The respondents in the PCAOB proceedings were Jay Westergard, a Grant Thornton partner, and Jennifer Nakao, both Certified Public Accounts ("CPA") employed by Grant Thornton. Aplt. App. 511, 526. The respondents stipulated to the allegations and did not contest the resulting sanctions. Aplt. App. 510, 525. In essence, the PCAOB orders allege that the respondents ignored data tending to show that iMergent's collection rates for EPTA contracts were below 50%—and thus were not "probable"—and that they otherwise failed to obtain reasonable assurances that iMergent's

representations of its historical collection rate were accurate. Aplt. App. 512-23; 527-37. The orders referenced several documents, including emails between Grant Thornton employees and spreadsheets and other documents created by iMergent. Aplt. App. 517, 518-19; 532, 534.

The district court denied Plaintiffs' motion, holding that the PCAOB orders were of dubious weight because they were merely summaries of the PCAOB's allegations, not proven facts, In re iMergent Sec. Ligit., 2010 WL 1331651 at *1, and because the orders were "not of such importance that they are likely to alter the outcome of the court's [prior order]." Id.

On appeal, Plaintiffs argue that the PCAOB orders give them a sufficient basis to allege Grant Thornton's scienter. The newly discovered evidence, they argue, shows that Grant Thornton was reckless because Grant Thornton approved iMergent's revenue-recognition practices despite being aware of information that the EPTA collection rate was below 50%. Aplt. Br. 41. They argue that Grant Thornton knowingly or recklessly ignored such information, and knowingly or recklessly failed to obtain reasonable assurances that iMergent's data on historical collection rates was correct. Aplt. Br. 41-43. Additionally, Plaintiffs argue that they could not have discovered the PCAOB orders before the district court dismissed the case because the PCAOB proceedings were closed, and because the PSLRA stays discovery until after a motion to dismiss has been denied. Aplt. Br. 49.

At the outset Plaintiffs argue that we should review the district court's order de novo for conclusions of law. Aplt. Br. 25-26. This is correct, but only in the context of our overall review for abuse of discretion: "A district court would necessarily abuse its discretion if it based its ruling on an erroneous view of the law." Lyons, 994 F.2d at 727 (internal quotation marks and citation omitted). We perceive no abuse of discretion here, on the basis of an erroneous legal conclusion or otherwise.

Plaintiffs' primary theory—as laid out in the SAC—is that Grant Thornton was reckless in approving iMergent's financial statements without any support for its position that a 53% collection rate constituted "probable collectibility" under SOP 97-2. Yet, the PCAOB allegations and the documents cited therein contain no information related to Grant Thornton's interpretation of SOP 97-2. Specifically, they do not identify readily available, unambiguous, applicable sources that foreclosed Grant Thornton's interpretation. Rather, the PCAOB orders directly contradict the SAC: the SAC alleges that Grant Thornton knew the collection rate for EPTAs, Aplt. App. 50; but the PCAOB sanctions are predicated on the notion that Grant Thornton did not know the actual collection rates. Aplt. App. 512, 519, 533.

As Plaintiffs have pointed out, the PCAOB orders could possibly support some of their allegations against Grant Thornton. Aplt. Br. 42-43. However, a suit predicated on the PCAOB orders would be markedly different than the suit

set forth in the SAC. A complaint based on the PCAOB orders would allege that Grant Thornton acted recklessly in failing to properly investigate iMergent's revenue-recognition practices—as opposed to the SAC, which alleged that Grant Thornton knew all the relevant facts yet acted recklessly in applying SOP 97-2 to those facts. In other words, the PCAOB allegations would possibly support a suit based on Grant Thornton's alleged failure to properly conduct an audit, not a suit based on whether Grant Thornton failed to properly apply a GAAP standard to an audit. Plaintiffs admit as much in their reply brief. Aplt. Rep. Br. 20 ("[T]he Complaint did not plead *any* evidence of GT's *knowledge* of improper accounting at iMergent, but was based instead on GT's reckless failure to have obtained any support for application of the 'more likely than not' standard of 'probable' collection. The PCAOB order, on the other hand, details information not alleged in the Complaint, including 'red flags' knowingly disregarded by GT . . . .").

The district court correctly noted that the PCAOB allegations contained no evidence that would remedy the previously identified deficiencies in the SAC. See In re iMergent Sec. Litig., 2010 WL 1331651 at *1. This conclusion is predicated on a proper view of the law and the facts of the case.

Further, Plaintiffs failed to establish that they met the requirements of Rule 60(b)(2). First, Plaintiffs never adequately explained why they could not have discovered the evidence underlying the PCAOB orders, had they practiced due diligence. Indeed, the record supports the conclusion that Plaintiffs could have

accessed the information. In the SAC, the Plaintiffs assert that iMergent provided them with "non-public documents . . . as well as interviews with present and former iMergent officers and directors." Aplt. App. 46. This information provided the basis for the SAC. Aplt. App. 46-47. In fact, iMergent's agreement to cooperate in the suit was a major factor in Plaintiffs' decision to settle its claims against iMergent and its directors. See Aplee. Supp. App. 101 ("[T]he Settling Defendants will provide [P]laintiffs evidence . . . with documentation and other evidence in support of [Plaintiffs'] claim . . . ." (quoting Doc. No. 141, Plaintiffs' Memorandum in Support of Plaintiffs' Motion for Leave to File a Second Amended Complaint as to the Sole Remaining Defendant Grant Thornton LLP)).

Plaintiffs did not explain to the district court, see Aplt. App. 505-06, and do not adequately explain to us, how and why they were unable to obtain the information that formed the basis of the PCAOB allegations. Given iMergent's extensive cooperation throughout the litigation, it appears that Plaintiffs could have accessed the information contained in the PCAOB orders, had they exercised due diligence. In any event, it is Plaintiffs' burden to establish that they were entitled to relief under Rule 60(b), and the district court could reasonably find that they did not establish that the evidence was unavailable to them.

Second, Plaintiffs have not established that they were indeed diligent in pursuing the information contained in the PCAOB orders. Actual diligence is one

of the requirements for relief under Rule 60(b)(2). Zurich N. Am., 426 F.3d at 1290; see also Miller v. Baker Implement Co., 439 F.3d 407, 414 (8th Cir. 2006) (to succeed on a Rule 60(b)(2) motion, the moving party must show "that the movant exercised diligence to obtain the evidence before entry of the order"); United States v. Fulcher, 250 F.3d 244, 249 (4th Cir. 2001) (noting that to succeed on a Rule 60(b)(2) motion, the moving party must allege facts "from which the court may infer diligence on the part of the movant" (internal quotation marks and citation omitted)). In their motion to the district court Plaintiffs merely offered the bare-bones assertion that "Plaintiffs were justifiably ignorant of the evidence despite due diligence." Aplt. App. 506. Likewise on appeal. See Aplt. Br. 48-50. Yet Plaintiffs themselves allege that they had access to iMergent's non-public documents. Aplt. App. 46-47. In exercising its discretion, the district court was not required to credit Plaintiffs' mere assertion of diligence, especially given the circumstances here, where Plaintiffs themselves allege extensive cooperation by iMergent.

Accordingly, the district court did not abuse its discretion in denying Plaintiffs' Rule 60(b) motion.

AFFIRMED.

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT
OFFICE OF THE CLERK

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RE: 09-4222 and 10-4074, Firestone, et al v. Imergent
Dist/Ag docket: 2:05-CV-00204-DB

Dear Counsel:

Attached is a copy of the opinion of the court in the captioned cases. Judgment was entered today.

Please contact this office if you have questions.

Sincerely,

Elisabeth A. Shumaker

Elisabeth A. Shumaker
Clerk of the Court

cc: Gary F. Bendinger
Christopher Sullivan

EAS/at